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Irish Life | 75 Years of Experience

Monthly Mindshare
June 2015

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Investment Manager
Irish Life Investment Managers

IRISH LIFE INVESTMENT MANAGERS

- Only Irish winner at 2014 European Pension Awards and
- Only Investment Manager to win two awards
- Irish Pension Awards 2014 – ‘Investment Manager of the Year’ and ‘Alternatives Investment Manager of the Year’

CONTENT

- Overview of DSC in MAPS
- Factors driving DSC
- DSC Factor update for end of May
- Investment Asset watch
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- Market signposts
- Economic review - Ireland, Eurozone, U.S., U.K. and Asia

DYNAMIC SHARE TO CASH IN MAPS

In May 2013, Irish Life Assurance launched their Multi Asset Portfolio range (MAPS) featuring the proprietary **Dynamic Share to Cash (DSC)** process designed by Irish Life Investment Managers.

Using a blend of market signals from three broad categories, the **DSC** aims to identify changes in long term market trends and reduce equity market exposure where signs of impending stress are indicated.

The three broad categories the process tracks are:

(1) Momentum - shorter term trends
(2) Valuations - ongoing, well established and defined market measures of value
(3) Macroeconomic - a top-down global economic perspective on markets

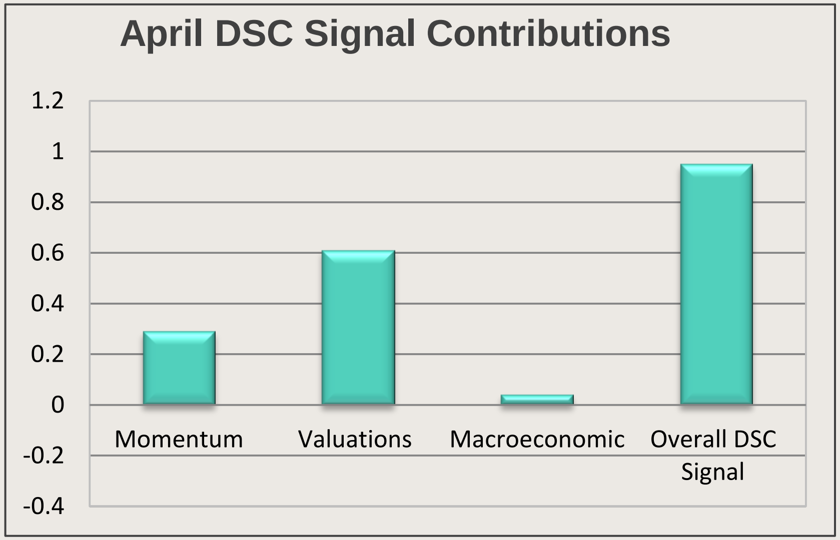
This month we examine…

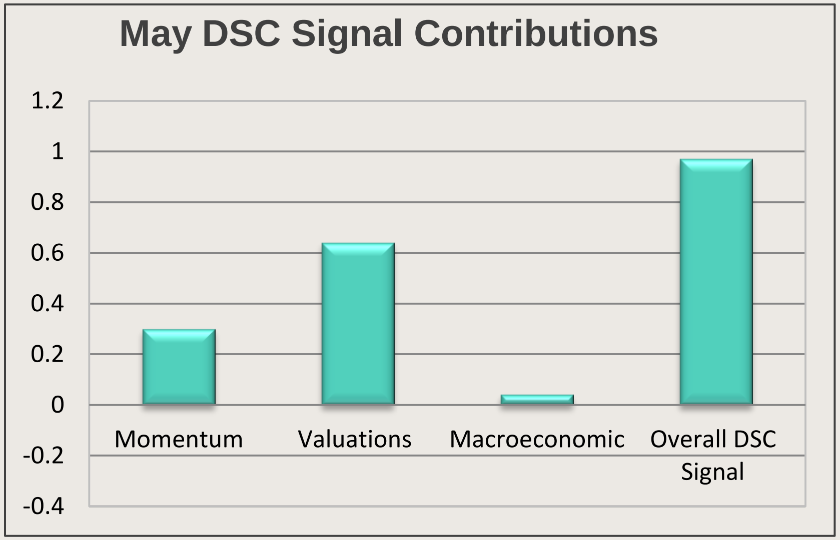
- Which factors were driving the DSC process in May and how the DSC signal was impacted as a result.
- What has been going on in the major economies around the globe through May.

DYNAMIC SHARE TO CASH - FACTORS

FACTOR CATEGORY	OBJECTIVE	INDIVIDUAL FACTOR EXAMPLES
1 MOMENTUM IN MARKETS	Take account of trends in shares	• 12 month share market momentum • 200 day moving average
2 VALUATIONS	Take account of the long-term valuation of shares	• Long-term share values • Earnings quality • Earnings yield • Earnings revisions
3 GLOBAL MACROECONOMICS	Take account of the influence of global economics on shares	• Real GDP growth rate • Bond yield curve slope • Energy price levels

DYNAMIC SHARE TO CASH – FACTOR UPDATE FOR MAY





- The ***DSC*** signal was little changed in May and only moved from 0.95 at the end of April to 0.97 at the end of May so remains in overall positive territory. All DSC related funds continue to be fully invested in their Developed Market Shares. Valuations is still the major contributor of the three factors as can be seen above.

- The **Momentum, Valuation** and **Macroeconomic** individual categories were also largely unchanged during the month.

ASSET WATCH

- **Equities**

  The global economic growth outlook, while modest compared to levels evident pre-crisis, is slowly improving, despite periodic concerns over potential slowdowns related to mid cycle soft patches. The improving macro backdrop is positive for the global earnings outlook. Global central banks remain supportive, committing to keep interest rates low for some time yet, facilitated by low levels of inflation. While asset purchases under QE3 in the US have ended, both the ECB and Bank of Japan have increased the level of stimulus and asset purchases they are undertaking. Flows into global equity markets have been positive over the last two years and are expected to continue. Valuations remain supportive of global equities, particularly relative to other assets, providing upside for further gains in equity markets. While mid to high single gains in equities are expected in 2015, greater volatility is likely to be evident as political events and economic and monetary developments give rise to fluctuations in markets from time to time.

- **Bonds**

  While absolute levels of yields in core Eurozone markets are low, policy initiatives from the ECB, including the recent sovereign bond purchase programme, probably cap upside in core yields and support further narrowing of peripheral spreads in the medium term. Continued low levels of inflation and supportive ECB policy measures could enable the Eurozone > 5 year benchmark to generate marginal positive returns in 2015.

- **Property**

  The Irish property market has been strong with activity at record levels, which are expected to remain high given the weight of buyer interest. Yields have compressed led by offices and has been supported by the yield gap against bonds. Prime office yields are expected to begin to stabilise with further falls expected in the retail and industrial sectors. Rental growth has been strong in the office sector due to limited supply and is expected to continue while rental growth can recover in the retail and industrial sectors after recent signs of stabilisation. With an overall sector yield of around 6%, Irish property is expected to return 8/10% pa over the next three years.

- **Cash**

  Cash returns are expected to remain low through 2015.

MARKET DEVELOPMENTS IN MAY

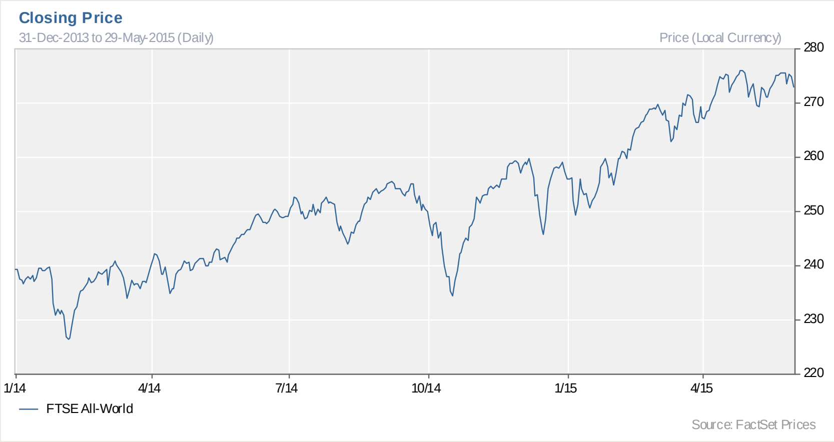
- Bond markets continued the sell off which began in mid April
- German 10 year yields move from a low of 5bps in mid April to a high of 78bps in May. The scale of the move in such a short period of time is unprecedented in recent years
- Higher yields were driven by easing deflation fears as Eurozone inflation went from a low of -0.6% y/y to flat y/y; the rebound in oil prices from January lows; deteriorating demand/supply dynamics in the bond market as an increase in sovereign bond net issuance exceeded buying interest from the ECB in May
- German 10 year yields declined from the May highs to end the month at 49bps as the ECB indicated it is front loading bond purchases to allow for deteriorating liquidity in mid summer, lower oil prices in May and ongoing uncertainties relating to Greece
- Greek negotiations remain ongoing with hopes for a resolution rising and fading at various stages through the month. With Greece set to run out of funds in early June, the urgency for an agreement has increased
- Completed earnings seasons beat expectations by 6%, 11% and 4% respectively in the US, Europe and Japan. Earnings upgrades were evident post results although they were modest in the US
- Global economic data stabilised and improved in some regions following the softer data in Q1
- Brent oil slipped -1.8% on continued increased production in the US and in OPEC countries, close to all time highs in US inventories and expectations of rising oil related investment in the second half due to recent higher prices
- The Euro fell to 1.096 against the US$ as the ECB reaffirmed its commitment to complete its asset purchase programme which is scheduled to end in September 2016 and on the announcement of the front loading of ECB bond purchases
- Global equities rose 1.0% (2.2% in €). Eurozone >5 year bonds fell -2.5%. Commodities fell -1.5% (+0.7% in €)

MARKET SIGNPOSTS

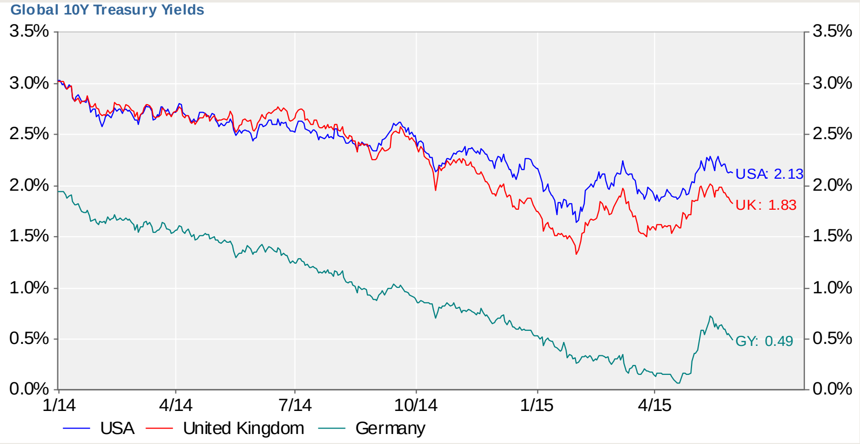
Markets In May		
	Local Returns	Euro Return
Ireland	4.2	4.2
UK	0.9	2.4
US	1.3	3.6
North America	1.2	3.2
Europe	1.0	1.3
Japan	5.2	3.7
Pacific	-1.0	-0.8
Emerging Markets	-2.5	-1.9
World	1.0	2.2
EMU Govt Bonds >5yr	-2.5	-2.5
Commodities	-1.5	0.7

Markets YTD		
	Local Returns	Euro Return
Ireland	22.4	22.4
UK	8.7	17.4
US	3.5	14.2
North America	3.5	13.8
Europe	15.4	19.2
Japan	20.3	28.3
Pacific	7.1	15.5
Emerging Markets	8.2	16.8
World	7.8	16.5
EMU Govt Bonds >5yr	1.8	1.8
Commodities	5.0	15.9

Equity Markets Move Slightly Higher



Global Bond Yields Rise



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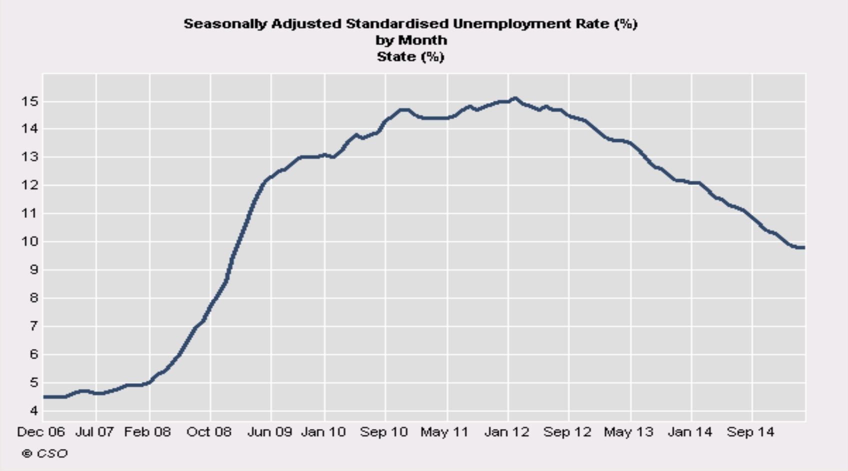
IRELAND ECONOMY REVIEW

Economy

- Economic releases generally remained positive
- Total numbers employed grew 0.6% in Q1 and by 41,300 or 2.2% y/y to 1.93m, the highest since Q2 2009
- Unemployment was revised down to 9.8%
- Retail sales rose 0.5% m/m and 11.9% y/y; core sales ex autos rose 3.1% m/m and 7.8% y/y
- Industrial production rose 3.0% m/m and 41.5% y/y
- The trade surplus fell to €3,425m from €3.798m, the lowest monthly surplus year to date although it was higher than all months in 2014 with the exception of December. Exports fell -2.0% m/m and imports rose 4.4% m/m
- The composite PMI fell -0.1 to a still high 59.7; manufacturing PMI fell -1.0 to 55.8; services fell -0.3 to 60.6
- National residential property prices rose 0.6% m/m and 15.8% y/y. Prices in Dublin rose 1.1% m/m and 20.2% y/y. Prices outside Dublin were up 0.3% m/m and 11.4% y/y
- CPI was flat m/m and was down -0.7% y/y
- April Exchequer returns were slightly disappointing as VAT and income tax receipts slowed. Nevertheless, the Exchequer deficit for the year was €2,319m v's €4,754m for the same period last year. Tax revenues for the year were up 11.3% versus 2014 and compared to a target rise of 4.9% for the year. Spending has been kept in check, rising only 0.4% y/y. Exchequer returns to date suggest the target of a fiscal deficit of 2.3% of GDP can be beaten

Irish Unemployment Rate Continues to Fall



Irish Residential Property Prices Remain Strong

EUROZONE ECONOMY REVIEW

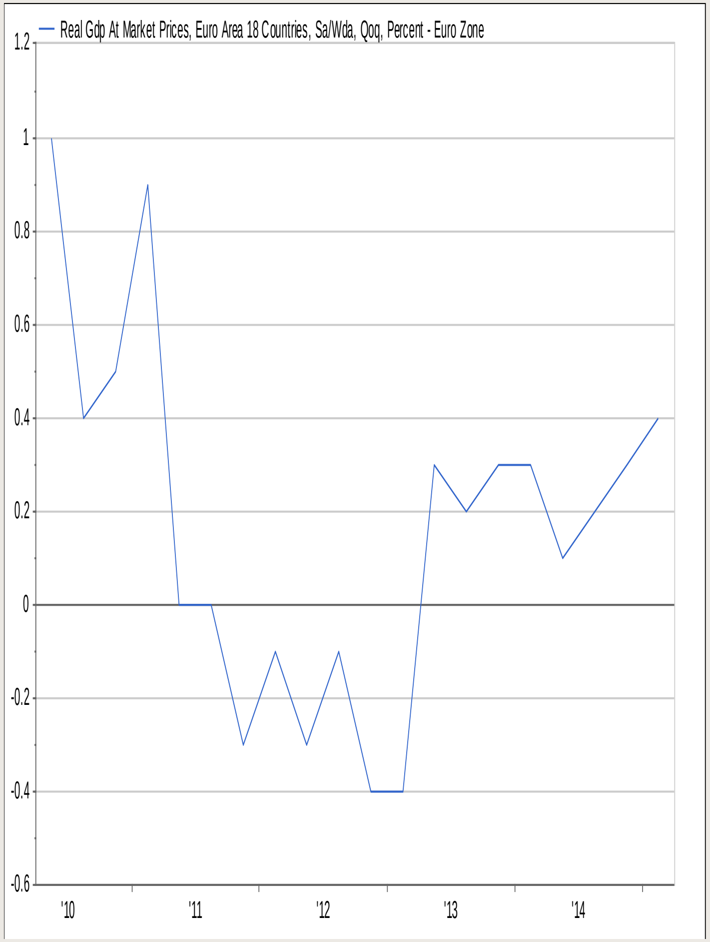
Economy

- Most releases were a touch softer compared to recent months
- Q1 GDP rose 0.4% q/q or 1.6% annualised v's 0.3% q/q in Q4
- The composite PMI fell -0.5 to 53.4; ZEW expectations fell -3.6 to 61.2; Sentix business sentiment fell -0.4 to 19.6
- Industrial production fell -0.3% m/m ; construction output rose 0.8% m/m; retail sales fell -0.8% m/m; consumer confidence fell -0.9 to -5.5; M3 money supply rose 5.3% y/y
- In Germany, sentiment surveys were weaker as the composite PMI fell -1.3 to 54.2; the IFO business climate fell -0.1 to 108.5; Q1 GDP grew 0.3% q/q; retail sales rose 1.7% m/m; consumer confidence rose 0.1 to 10.2, the highest level since October 2001. Industrial production fell -0.5% m/m although factory orders rose 0.9% m/m
- French Q1 GDP rose 0.7% q/q; the composite PMI rose 0.4 to 51.0. Business confidence rose 1 to 97; consumer confidence fell -1 to 93 although consumer spending rose 0.1% m/m; industrial production fell -0.3% m/m
- In Spain, the composite PMI rose 2.2 to 59.1, industrial production rose 2.9% y/y; retail sales rose 4.0% y/y
- Italian Q1 GDP rose 0.3% q/q; the composite PMI rose 1.5 to 53.9; industrial production rose 0.4% m/m. Retail sales fell -0.1% m/m

Interest Rates

- There was no ECB monetary policy meeting in May
- Minutes for the April meeting indicated a desire to fully implement and complete the asset purchase programme which is scheduled to end in September 2016
- It was believed the full benefit of the programme would only be felt if governments also implemented reforms
- The Governing Council concluded that risks about the scarcity of bond market supply linked to the asset purchase programme had been overstated and there was no need to consider any changes to the monetary stance
- In the middle of the month, the ECB vice President indicated the ECB would front load asset purchases under the programme during the early summer months to allow for lower liquidity in markets during the middle summer months.

Eurozone Q 1 GDP Improves



U.S. ECONOMY REVIEW

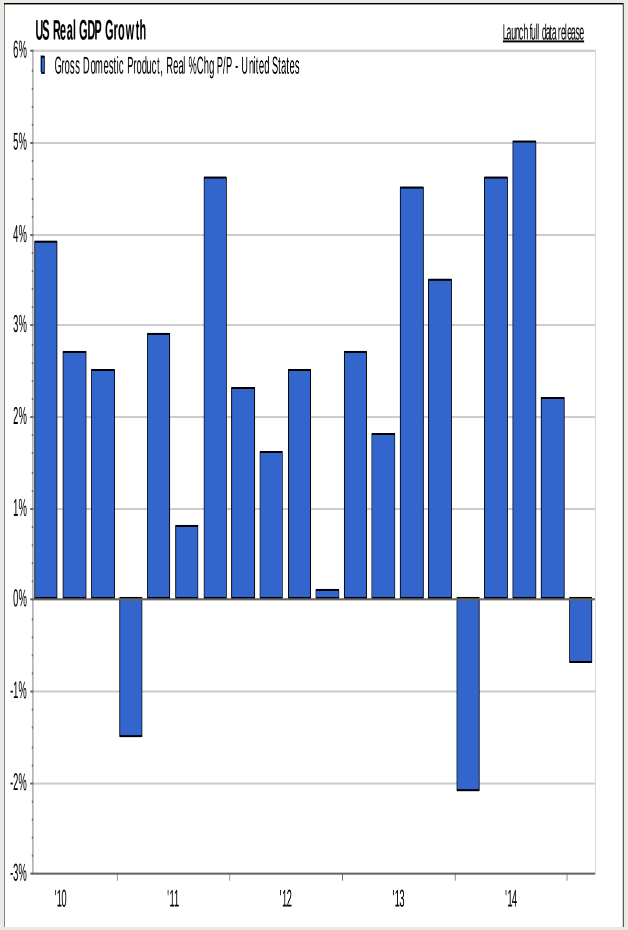
Economy

- US economic data was more mixed after recent weakness
- Q1 GDP was revised down to -0.7% annualised due to downgrades to personal consumer expenditure, government spending and higher imports
- ISM manufacturing was unchanged at 51.5; services rose 1.3 to 57.8; the composite PMI fell -0.4 to 57.0; small business confidence rose 1.7 to 96.9
- Non-farm payrolls rose 223,000; unemployment fell 0.1% to 5.4%; Industrial production fell -0.3% m/m; factory orders rose 2.1% m/m
- Headline retail sales were flat m/m; consumer confidence rose 1.1 to 95.4
- CPI rose 0.2% m/m and fell -0.1% y/y. Core CPI ex food and energy rose 0.3% m/m and 1.8% y/y
- Durable goods orders fell -0.5% m/m; the previous month was revised 1.1% higher to 5.1%;.orders ex transport rose 1.0% m/m; capital goods shipments rose 0.8% m/m
- House prices in the top 20 cities rose 1.0% m/m and 5.0% y/y; housing starts and building permits rose 20.2% and 10.1% m/m respectively, the best in 7 years; new home sales rose 6.8% m/m; existing home sales fell -3.3% m/m

Interest Rates

- There was no Fed policy meeting in May
- The April minutes effectively ruled out an interest rate rise in June with conditions not expected to improve enough to justify a rise by then
- There was broad agreement that rates would rise in 2015 but no consensus on when or what the trigger would be
- There was greater uncertainty regarding the economic outlook following the recent softer data and debate regarding the interpretation of varying inflation expectations

U.S. Q1 GDP Negative



U.K. ECONOMY REVIEW

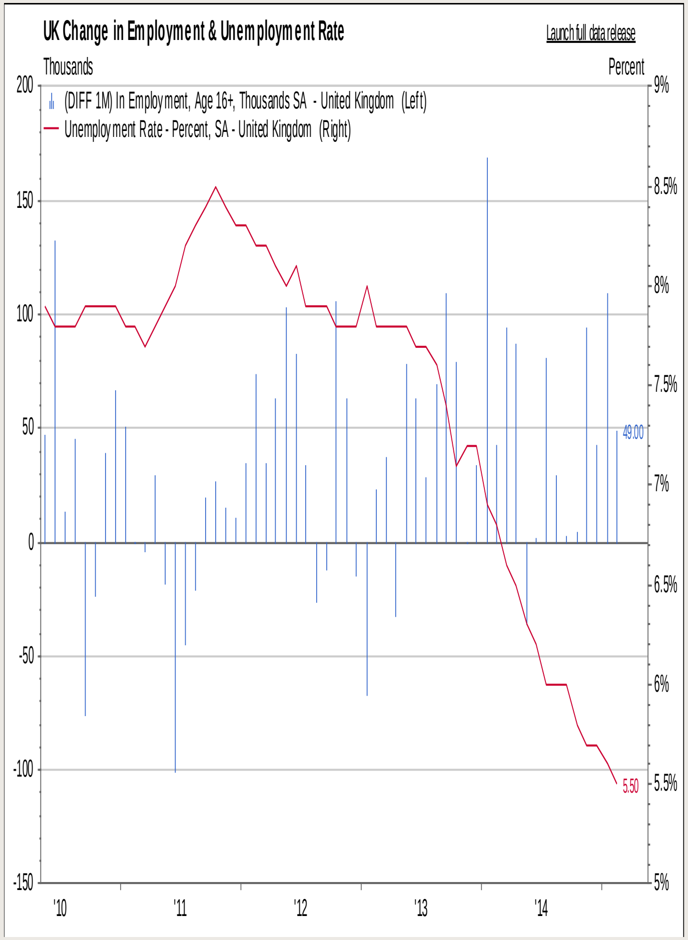
Economy

- UK data was mixed but generally stronger
- Q1 GDP was unchanged at 0.3% q/q or 2.4% y/y. Services was revised down by 0.1% to 0.5% q/q; gross fixed capital formation grew 3.9% q/q but much of this was due to inventories with business investment up only 1.7% q/q
- The composite PMI fell -0.4 to 58.4 with manufacturing down -2.5 to 51.9, services up 0.6 to 59.5 and construction down -3.6 to 54.2
- Core retail sales ex autos and fuel rose 1.2% m/m and 4.7% y/y; consumer confidence fell -3 to 1
- Unemployment fell 0.1% to 5.5%; numbers employed rose 202,000 over three months; average weekly earnings ex bonuses rose 2.2% annualised over 3 months
- Industrial production rose 0.5% m/m; construction rose 3.9% m/m
- The Halifax house price index rose 1.6% m/m and 8.5% annualised over 3 months
- CPI rose 0.2% m/m but fell -0.1% y/y, a record low

Interest Rates

- The BoE unanimously agreed to leave policy unchanged
- Two members again described the rate decision as finely balanced
- There was general agreement that inflation would rise notably by year end and that interest rates were likely to rise over the next 3 years
- There was however ongoing debate and disagreements over the level of slack in the economy, the path of wage growth and productivity and as a result, the expected timing of the first rate rise and level of interest rates
- In the Inflation Report, growth forecasts were downgraded but inflation forecasts were left more or less unchanged as estimates for productivity growth were lowered
- The BoE saw the future path of interest rates broadly in line with market forecasts of two 25bps increases in 2016 and two further 25bps increases by mid 2018
- The slightly more hawkish tone of the Inflation Report pulled forward expectations for the 1st rate rise to May 2016

U.K. Labour Market Remains Strong



ASIAN ECONOMY REVIEW

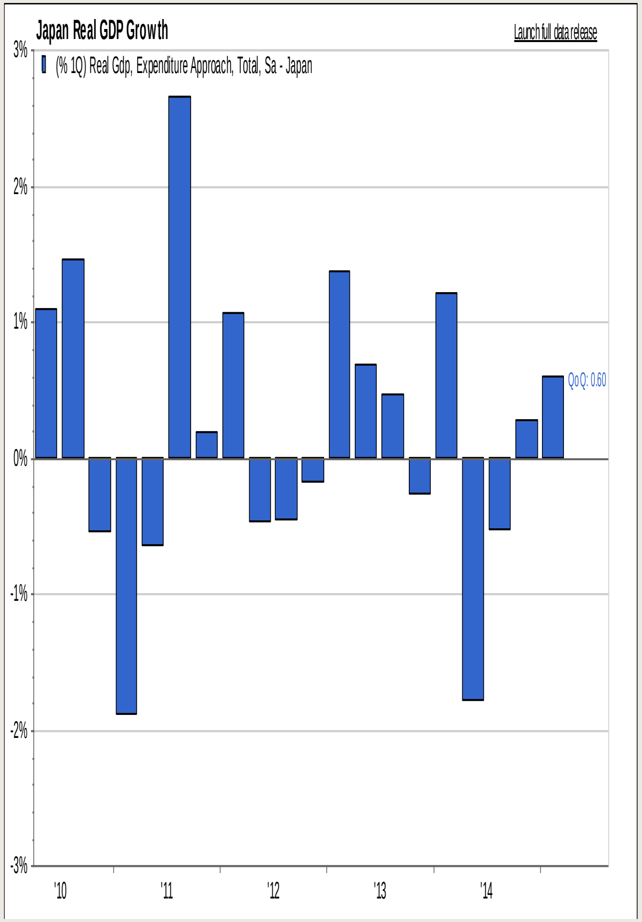
Japanese Economy

- Economic releases generally improved
- Q1 GDP surprised positively, rising 0.6% q/q or 2.4% annualised with consumption and business spending both up 0.4% q/q while inventories added 0.5% to quarterly growth. Industrial production rose 1.0% m/m; machine orders rose 2.9% m/m; retail sales rose 0.4% m/m; consumer confidence slipped -0.2 to 41.5; exports rose 8.0% y/y and imports fell -4.2% y/y; all key PMI's moved back above 50 with the composite PMI at 50.7; the Economy Watchers survey current reading rose 1.4 to 53.6 while the outlook reading rose 0.8 to 54.2; bank lending was unchanged at 2.7% y/y; the tertiary index fell -1.0% m/m; CPI was up 0.6% y/y
- The Bank of Japan (BoJ) left policy unchanged. The BoJ remains confident the economy will recover and slightly upgraded the economic assessment, saying the economy continues to recover moderately. Private consumption was described as being resilient with a steady improvement in employment and income. The more positive tone pushed out expectations for further monetary easing to later in the year from mid year. Minutes for the meeting were more cautious, highlighting downside risks to inflation and risks to the economy from a planned sales tax rise in 2017

Chinese Economy

- Chinese data continued to disappoint
- The HSBC composite PMI index fell -0.5 to 51.3 as manufacturing remained below 50 at 49.1 although services rose 0.6 to 52.9
- Official manufacturing PMI was unchanged at 50.1; services fell -0.3 to 53.4
- Exports fell -6.2% y/y; imports fell -16.1 y/y
- Retail sales growth slowed to 10.0% y/y from 10.2%; industrial production growth improved to 5.9% y/y from 5.6%; fixed asset investment slowed to 12.0% y/y from 13.5%
- Industrial profits rose 2.6% from -0.4% previously
- New lending was below expectations at Rmb708bn and was down -40.0% m/m

Japanese Q1 GDP Surprises Positively



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